

701—54.2(422) Allocation or apportionment of investment income.

54.2(1) The classification of investment income by the labels customarily given them, such as interest, dividends, rents, and royalties, is of no aid in determining whether that income is business or nonbusiness income. Interest, dividends, rents, and royalties shall be apportioned as business income to the extent the income was earned as a part of a corporation's unitary business, a portion of which is conducted in Iowa. *Mobil Oil Corp. v. Commissioner of Taxes*, 455 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 73 L.Ed.2d 787, 102 S.Ct. 3103 (1982); *F. W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354, 73 L.Ed.2d 819, 102 S.Ct. 3128 (1982); *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 77 L.Ed.2d 545, 103 S.Ct. 2933 (1983). Whether investment income is part of a corporation's unitary business income depends upon the facts and circumstances in the particular situation. The burden of proof is upon the taxpayer to show that the treatment of investment income on the return as filed is proper. There is a rebuttable presumption that an affiliated group of corporations in the same line of business have a unitary relationship, although that is not the only element used in determining unitariness.

54.2(2) All business income, including capital gains or losses, may at the taxpayer's election be included in the computation of the denominator of the business activity formula provided, however, that a taxpayer cannot elect to exclude or include business investment income where the election would result in an understatement of net income reasonably attributable to Iowa.

For a tax year which begins on or after January 1, 1984, if the taxpayer has investment income which is deemed to be business income under the provisions of this rule, a written election shall be made. The election must state whether the taxpayer wishes to include or exclude investment income which is deemed to be business income under the provisions of this rule in the computation of the business activity formula. The election shall be signed by a duly authorized officer of the corporation. The election is binding on all future tax years unless the taxpayer is granted permission by the director to change the election. If the taxpayer fails to make a written election, the fact that investment income was or was not included in the computation of the business activity formula shall be deemed to be the taxpayer's election for all future tax years.

If the taxpayer makes an election to include investment income deemed to be business income in the computation of the denominator of the business activity ratio, the computation of the business activity ratio is as follows:

a. Interest income from accounts receivable. Accounts receivable interest income is included in the numerator of the business activity formula if the taxpayer receives accounts receivable interest income from customers located in Iowa. Accounts receivable interest income which cannot be segregated by geographical source shall be included in the numerator of the business activity ratio applying the same ratio as gross receipts within Iowa bear to total gross receipts.

EXAMPLE: The taxpayer operates a multistate chain of gasoline service stations, selling for cash and on credit. Interest is charged on credit sales, but the interest income cannot be segregated by geographical source. During the tax year, the taxpayer had gross receipts within Iowa of \$300,000, total gross receipts everywhere of \$1,000,000, and accounts receivable interest income everywhere of \$10,000. Ten thousand dollars would be included in the denominator of the business activity formula, and 30 percent of \$10,000, or \$3,000, would be included in the numerator of the business activity formula.

b. Interest income other than accounts receivable. All other interest income determined to be business income, except nontaxable interest income, shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

c. Dividend income. All dividend income (net of special deductions) determined to be business income shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

d. Rental income. All rental income determined to be business income shall be included in the numerator of the business activity formula to the extent that property is utilized in Iowa or in its entirety if the taxpayer's commercial domicile is in Iowa and the taxpayer is not taxable in the state in which the property is utilized. The extent of utilization of tangible personal property in a state is determined by

multiplying the rent by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of the property during the rental period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

e. Royalty income. All royalty income from intangible personal property determined to be business income shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa. All royalty income from tangible personal property or real property determined to be business income shall be included in the numerator of the business activity formula if the situs of the tangible personal property or real property is within Iowa.

f. Gain or loss from the sale, exchange, or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was used in the taxpayer's trade or business, shall be apportioned by the business activity ratio applicable to the return for the year the gain or loss is included in taxable income and shall be included in the computation of the business activity ratio as follows:

(1) Gain or loss from the sale, exchange, or other disposition of real property shall be included in the numerator if the property is located in this state.

(2) Gain or loss from the sale, exchange, or other disposition of tangible personal property shall be included in the numerator if:

The property has a situs in this state at the time of sale; or

The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Gains or loss from the sale, exchange, or other disposition of intangible personal property shall be included in the numerator if the taxpayer's commercial domicile is in this state.

(4) All gains or loss shall be included in the denominator of the activity ratio.

Noninclusive examples of gains or loss from the sale, exchange or other disposition of real or tangible or intangible property which may not be included in the computation of the business activity ratio because to do so would result in an understatement of net income reasonably attributable to Iowa are the gain recognized under an election pursuant to Section 338 of the Internal Revenue Code or gain recognized under Section 631(a) of the Internal Revenue Code.

g. Other miscellaneous income. All other miscellaneous income determined to be business income shall be included in the computation of the business activity formula to the extent such income items do not represent a recapture of expense.

h. Income which is not subject to Iowa tax shall not be included in the computation of the business activity ratio.

Subrules 54.2(1) and 54.2(2) are effective for tax years beginning on or after January 1, 1983.

54.2(3) For tax years beginning on or after January 1, 1995, all investment income that is business income, including capital gains or losses, shall be included in the computation of the denominator of the business activity formula if the investment income is derived from intangible property that has become an integral part of some business activity occurring regularly in or outside of Iowa. See subrule 52.1(4). All other investment business income, including capital gains or losses, may at the taxpayer's election be included in the computation of the denominator of the business activity formula provided, however, that a taxpayer cannot elect to exclude or include investment business income where the election could result in an understatement of net income reasonably attributable to Iowa. A taxpayer cannot elect to include some investment business income in and exclude other investment business income from the business activity formula. The election applies to all investment income of the taxpayer subject to the election.

For a tax year which begins on or after January 1, 1995, if the taxpayer has investment income subject to an election under the provisions of this rule, a written election shall be made. The election must state whether the taxpayer wishes to include or exclude investment income which is deemed to be business income subject to election under the provisions of this rule in the computation of the business activity formula. The election shall be signed by a duly authorized officer of the corporation. The election is

binding on all future tax years unless the taxpayer is granted permission by the director to change the election. If the taxpayer fails to make a written election, the fact that investment income was or was not included in the computation of the business activity formula shall be deemed to be the taxpayer's election for future years.

The computation of the business activity formula associated with investment income is as follows where the investment income is required to be included in the business activity formula or where an election for inclusion has been made:

a. Interest income from accounts receivable. If an inclusion election is made, accounts receivable interest income is included in the numerator of the business activity formula if the taxpayer receives accounts receivable interest income from customers located in Iowa. Accounts receivable interest income which cannot be segregated by geographical source shall be included in the numerator of the business activity ratio applying the same ratio as gross receipts within Iowa bear to total gross receipts.

EXAMPLE: The taxpayer operates a multistate chain of gasoline service stations, selling for cash and on credit. Interest is charged on credit sales, but the interest income cannot be segregated by geographical source. During the tax year, the taxpayer had gross receipts within Iowa of \$300,000, total gross receipts everywhere of \$1,000,000, and accounts receivable interest income everywhere of \$10,000. \$10,000 would be included in the denominator of the business activity formula, and 30 percent of \$10,000, or \$3,000, would be included in the numerator of the business activity formula.

b. Interest income other than accounts receivable. All other interest income determined to be business income, except nontaxable interest income, shall be included in the numerator of the business activity formula to the extent that the interest-bearing asset is an integral part of some business activity occurring regularly in Iowa. If the interest-bearing asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the interest therefrom (except nontaxable interest income) shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: The taxpayer earns interest income from loans to affiliated corporations, commercial paper, bonds issued by multistate corporations, and federal income tax refunds. The interest income is business income. None of these interest-bearing assets are an integral part of some business activity occurring regularly within or without Iowa. Accordingly, the interest income produced by such assets is subject to an election of inclusion in or exclusion from the business activity formula.

c. Dividend income. All dividend income (net of special deductions) determined to be business income shall be included in the numerator of the business activity formula to the extent that the dividend asset is an integral part of some business activity occurring regularly in Iowa. If the dividend asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the dividends shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: The taxpayer earns dividend income from dividends payable from a mutual fund. The dividend income is business income. The dividends are not an integral part of some business activity occurring regularly within or without Iowa. Assume that the taxpayer had also earned interest income which was business income and which was not an integral part of some business activity occurring regularly within or without Iowa and that the taxpayer had included that interest income in the business activity formula. Under these circumstances, the taxpayer must also include the dividend income in the business activity formula. If no inclusion of investment business income had been made in the business activity formula, the taxpayer would exclude the dividend income from the formula.

d. Rental income. If an inclusion election is made, all rental income determined to be business income shall be included in the numerator of the business activity formula to the extent that property is utilized in Iowa or in its entirety if the taxpayer's commercial domicile is in Iowa and the taxpayer is not taxable in the state in which the property is utilized. The extent of utilization of tangible personal property in a state is determined by multiplying the rent by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental periods in the taxable year. If the physical location of the property during the rental

period is unknown or not ascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental payer obtained possession.

e. Royalty income and licensing fees. All royalty income and licensing fees from intangible personal property determined to be business income shall be included in the numerator of the business activity formula to the extent that the royalty or licensing asset is an integral part of some business activity occurring regularly in Iowa. If the royalty or licensing asset is not an integral part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion is made, the royalties or licensing fees shall be included in the numerator of the business activity formula if the taxpayer's commercial domicile is in Iowa.

EXAMPLE: A, a corporation with a commercial domicile outside of Iowa, derives royalties from a trade name that is used by other corporations doing business in Iowa in their Iowa businesses. Since the royalty asset is an integral part of an Iowa business activity, A must include the royalties associated with Iowa business activity in the numerator of A's business activity formula.

EXAMPLE: The taxpayer, a corporation with a commercial domicile in Iowa, derives license fees from others who do business solely outside of Iowa. The license fees are business income. The license fees are an integral part of some business activity carried on regularly by the others outside of Iowa. The taxpayer must include the license fees in the business activity formula. If the taxpayer also had other license fees which were business income and which were not an integral part of some business activity occurring regularly within or without Iowa, these other license fees would be subject to an election of inclusion in or exclusion from the business activity formula.

If an inclusion election is made, all royalty income from tangible personal property or real property determined to be business income shall be included in the numerator of the business activity formula if the situs of the tangible personal property or real property is within Iowa.

f. Gains or losses. Gain or loss from the sale, exchange, or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer's trade or business carried on in Iowa, shall be apportioned by the business activity ratio applicable to the return for the year the gain or loss is included in taxable income and shall be included in the computation of the business activity ratio as follows:

(1) Gain or loss from the sale, exchange, or other disposition of real property shall be included in the numerator if the property is located in this state and if an election of inclusion has been made.

(2) Gain or loss from the sale, exchange, or other disposition of tangible personal property shall be included in the numerator if an election of inclusion has been made and if the property has a situs in this state at the time of sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Gain or loss from the sale, exchange, or other disposition of intangible personal property shall be included in the numerator of the business activity formula to the extent that the intangible personal property is an integral part of some business activity occurring regularly in Iowa in the tax year that gain or loss is recognized. If the intangible personal property is not an integral part of some business activity occurring regularly in or outside of Iowa in the tax year that gain or loss is recognized and if an election of inclusion has been made, the gain or loss shall be included in the numerator if the taxpayer's commercial domicile is in this state.

EXAMPLE: The taxpayer carries on its trade or business within and without Iowa. The taxpayer has patents which it licenses others to use in activities within and without Iowa. The patents are an integral part of business activity occurring regularly within and without Iowa. The taxpayer receives royalty income for the use of the patents. The taxpayer sells the patents and realizes a capital gain. The capital gain from the sale of the patents cannot be segregated by geographical source. Assume that the taxpayer is on a calendar tax year. Assume that the sale occurred on July 1. From January 1 to July 1, 5 percent of the royalties were attributable to some business activity regularly occurring in Iowa. The taxpayer should include 5 percent of the capital gain in the numerator of the business activity formula.

(4) All gain or loss shall be included in the denominator of the business activity ratio if an election of inclusion has been made or if the gain or loss is required to be included in the business activity ratio.

Noninclusive examples of gains or losses from the sale, exchange, or other disposition of real or tangible or intangible property may not be included in the computation of the business activity ratio, because to do so would result in an understatement of net income reasonably attributable to Iowa and would include the gain recognized under an election pursuant to Section 338 of the Internal Revenue Code and the gain recognized under Section 631(a) of the Internal Revenue Code.

g. Other miscellaneous income. All other miscellaneous income determined to be business income which is not subject to an election or which is the subject of a proper election of inclusion shall be included in the computation of the business activity formula to the extent such income items do not represent a recapture of expense. The miscellaneous income shall be included in the numerator of the business activity formula if the income is from an Iowa source.

h. Other investment income. All other investment income shall be included in the numerator of the business activity formula to the extent that the intangible personal property which produced that income is an integral part of some business activity occurring regularly in Iowa. If the intangible personal property is not part of some business activity occurring regularly in or outside of Iowa and if an election of inclusion has been made, the other investment income shall be included in the numerator if the taxpayer's commercial domicile is in this state.

i. Activity ratio. Income which is not subject to Iowa tax shall not be included in the computation of the business activity ratio.

54.2(4) Grossed-up foreign income. For purposes of administration of the Iowa corporation income tax law, gross-up (Section 78 of the Internal Revenue Code) shall be considered to be nonbusiness income, irrespective of the fact that the income creating the gross-up may be business income, and shall be allocated to the situs of the income payor.

This rule is intended to implement Iowa Code Supplement sections 422.32(2) and 422.33(1).